Composite and Garments

Sector Study

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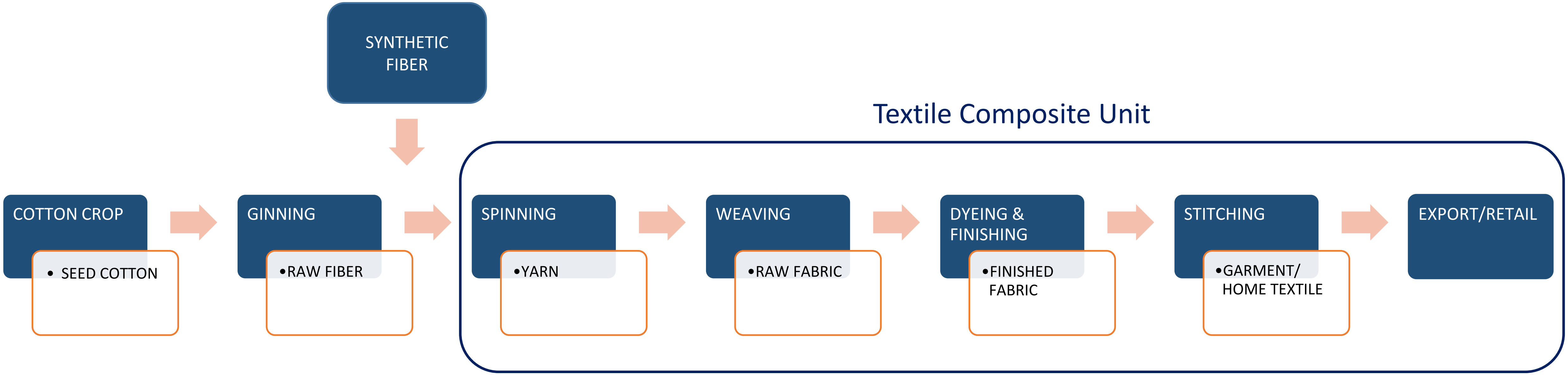
Introduction

- The textile cluster has a relatively large value chain with multiple distinct sectors.
- The following flow chart depicts the major processes along with the output of every process of the textile cluster's value chain
- A composite textile unit comprises of two or more processes from spinning of yarn till finished goods are produced.



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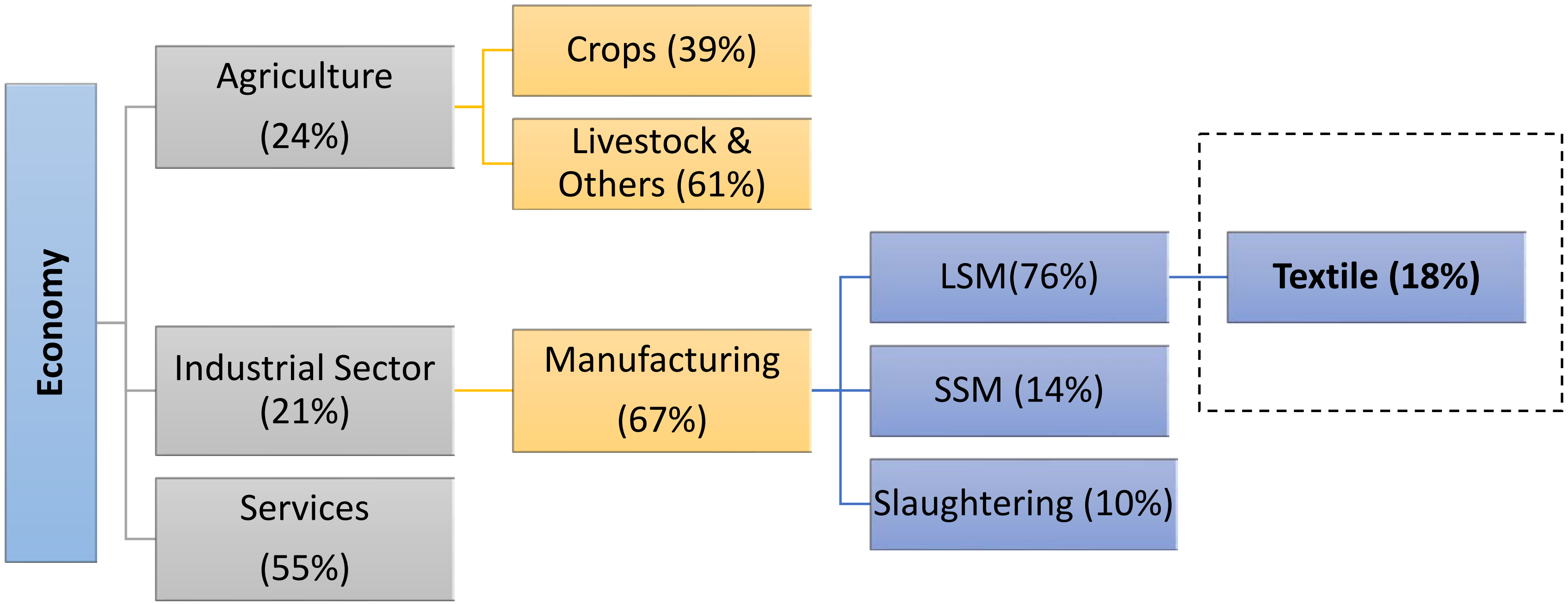
Global Industry Overview

- **Size:** The market size of the global textile and apparel industry is estimated to be USD~605bln in CY22 as compared to USD~551bln in CY21. This represents a growth rate of ~9.9%.
- **Demand Drivers:** The growth of textile industry in CY22 has slowed due to the Russian-Ukraine war fueling a global commodity super-cycle which has fueled inflation globally, on the one hand, and overheated, highly inflationary economies being pushed into recession, on the other hand.
- **Region Wise Textile Market:** The largest regional textile market is Asia-Pacific. It includes countries such as India, China and Pakistan which are amongst the top producers of cotton. Moreover, due to the availability of cheap labor, these countries along with Bangladesh have become textile producing hubs. They cater to both growing local demand and export demand from other regions.
- China is the largest exporter of textiles followed by India, Bangladesh and Vietnam. Meanwhile, the European Union and United States are two of the largest importers of textile finished goods such as garments and apparel.
- In CY22, the US has actively sought to ban cotton imports from China's Xinjiang region as a new act, the Uyghur Forced Labor Prevention Act has now been enacted which will give US to seize imports from the region. This enforcement comes in response to efforts to ban forced labor from the region.
- This will be detrimental to China which accounted for ~24% of world cotton production. ~89% of China's cotton was grown in the Xinjiang region in China in MY21/22.

Source: Business Research Company, USDA, The Guardian,

Local Economy and Textile Industry | An Overview

- In FY22 Pakistan's GDP (nominal) stood at PKR~66.9trln (FY21: PKR~55.8trln) and posted a growth in real terms of ~6.0% (FY21: ~5.7%). Industrial activities in FY22 represented ~19% share in the GDP while manufacturing activities represent a ~76% value addition in industrial activities.
- Large Scale Manufacturing (LSM) in Pakistan is essential for economic growth considering its linkages with other sectors, as it represents ~76% value of all manufacturing activities in FY22. The LSM grew by ~11.7% in FY22 (FY21: ~11.3%) but declined by ~0.4% in the 3MFY23 period.
- The textile sector is classified as a Large Scale Manufacturing (LSM) industrial component within the industrial sector. In FY21 and FY22, the textile industry's weight in the QIM was ~18.2%.



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Overview | Local Industry

- The overall textile industry contributes ~8.5% to the GDP of the country, which amounted to a market size of PKR~3,923bln in FY22 as compared to PKR~3,512bln in the SPLY. However in the 4MFY23, the size was reported as PKR~3,847bln owing to slowdown in sector activity.
- In FY22, the export contribution from textile segment was of PKR~3,349bln (~61% of total country exports) and grew by ~102% from PKR~3,379bln in FY21. This increase was attributable to the opening up of the global economy and increase in demand for textile exports after enduring COVID-19 related lockdowns during FY20 and FY21.
- As explained later in the report, the first quarter of FY23 was marked with a visible slowdown in textile exports owing majorly to global economic slowdowns and high inflation.
- Textile composite entities encompass the majority of processes within the textile value chain. These units have applied forwards or backwards integration in order to increase efficiencies. There are around 50 organized textile composite entities operating in the country, 30 of which are listed on the Pakistan Stock Exchange. The market capitalization of listed composite firms stood at PKR~208bln as on 18th November, 2022.
- There is a high level of product differentiation achieved as a variety of finished goods are produced including knitwear, towels, home textiles and a range of readymade garments. Some units also sell yarn and unprocessed fabric.

Sector Overview	FY20	FY21	FY22	4MFY23
Textile Industry Size (PKR bln) [Estimate]	3,237	3,512	3,923	3,847
Contribution to GDP	8.5% of GDP			
No of Players	~56 Players			
Textile Exports Value (PKR bln)	1,972	2,461	3,439	1,324
Share of Total Country Exports	**59%**	**61%**	**61%**	**61%**
Share of Total Country Imports	**6%**	**7%**	**6%**	**6%**
Textile Imports Value (PKR bln)	399	616	851	288
Industry Association	All Pakistan Textile Mills Association (APTMA)			

Source: PBS, TCO, PSX, PBIT

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Local Industry | Cotton Dynamics | Pre-floods

Pakistan's Cotton Supply (Bales 000s)							
	FY16	FY17	FY18	FY19	FY20	FY21	FY22
Opening Stock	**550**	**-**	**440**	**681**	**821**	**1,652**	**1,648**
Production	9,917	10,671	11,946	9,861	9,148	7,064	8,328
Imports	2,453	2,976	3,251	2,439	2,777	5,037	4,562
Total supply	**12,920**	**13,647**	**15,637**	**12.981**	**12,746**	**13,753**	**14,538***
Local consumption	12,633	13,060	14,749	12,085	11,019	12,102	13,995
Exports	287	147	207	75	75	3	16
Closing stock	**-**	**440**	**681**	**821**	**1,652**	**1,648**	**526**

- The majority of Pakistan's crop is grown in Punjab (~71.9%) and Sindh (~25.3%) while KPK and Balochistan share a relatively smaller segment of the total growing area. Pakistan's cotton production increased by ~8.9% in FY22 (FY21: ~-22.8%) due to an improvement in yield by ~25.4% (FY21: ~-6.3%), conducive weather conditions, smooth input supplies, and better crop management practices.
- Despite these promising results, Pakistan missed its cotton production target for 2021-22 of ~10.5mln bales (SPLY: ~10.9mln) owing to drought, high temperatures and dry weather at the start of the season, achieving a production of ~8.3mln bales (SPLY: ~7.1mln). In FY23 a production target of ~11 mln bales was hoped to be achieved, a figure which will be significantly revised following the monsoon flash floods (as discussed in the report) .
- FY22 was the first year Pakistan's net imports of raw cotton declined after previously dipping in FY19. Prior to FY22, cotton imports rose by ~78.1% over the FY17-FY21 period. The ~9.5% decline in FY22 imports can be attributable to the significant currency depreciation serving to increased import prices as well as a ~18% YoY increase in local production.
- Prior to the monsoon (Aug-22) flash floods, the proposed cotton crop target for the 2022-23 season was ~11.03mln bales) of which ~59.8% had been budgeted for Punjab and ~36.3% for Sindh and the remainder for KPK and Balochistan.

Mill consumption has been calculated based on average total cotton consumption for FY16-21

Source: PBS, Economic Survey, 2021-22, PCCC

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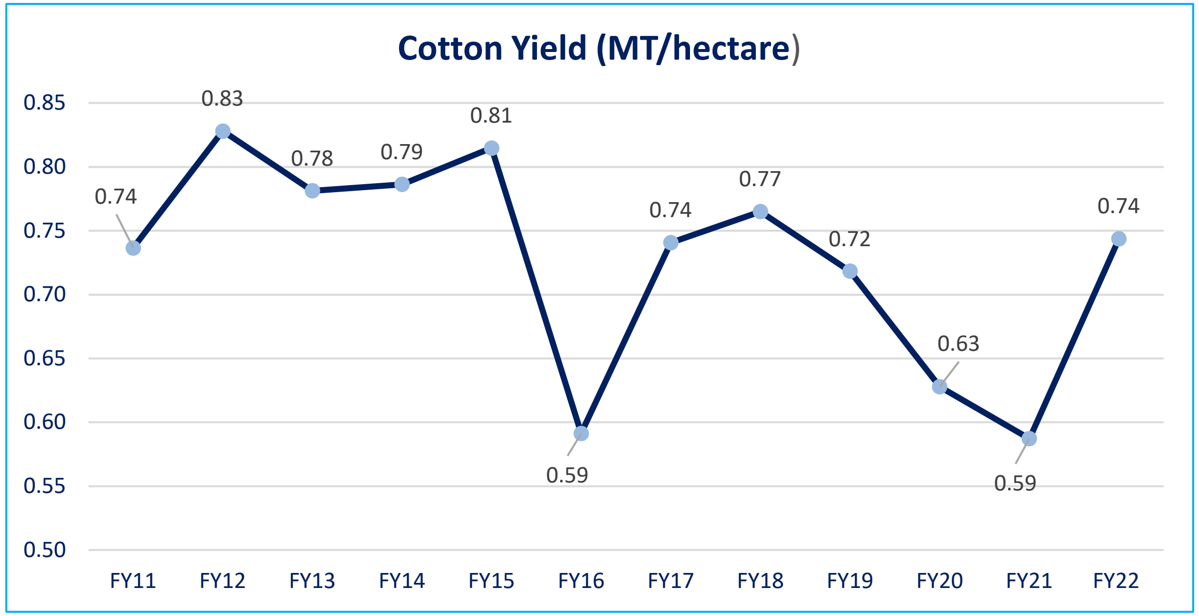
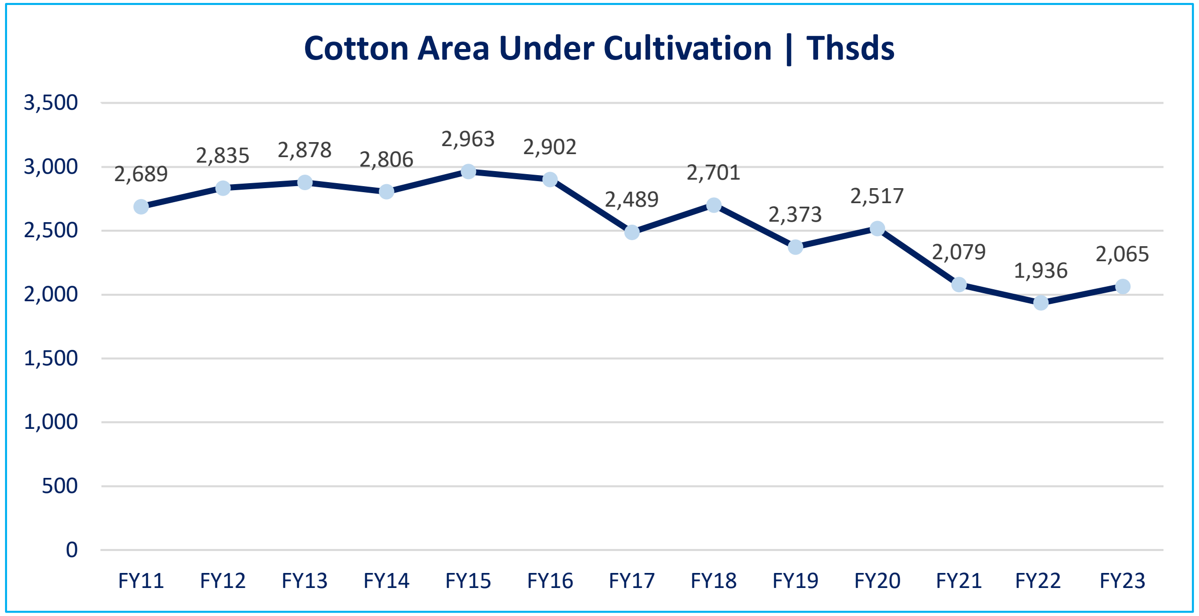
Cotton Dynamics| Cultivation Area and Yield | Before the Flash Floods





- The improvement in cotton yield came despite the fact that the area under cultivation decreased by ~6.9% in FY22 (FY21 decrease: ~-17.4%). The area under cultivation in FY23 Kharif season has been recorded at ~2.1mln hectares, a ~6.7% increase from FY22 when the area under cultivation was ~1.94mln hectares.
- Climate change related factors - heat wave and unprecedented water shortages at sowing time, March-22 onwards, and replacement of cotton by other crops, such as sugarcane and maize, explain the decline in area under cultivation in FY22.
- For FY23 (pre-floods), the sowing of the cotton crop for the 2022-23 season has been complete in Punjab and is in its final stages in Sindh. The cultivated area of cotton in Punjab is ~1.5mln hectares (~81.5% of the FY23 target), ~16.1% higher than previous year but ~18.5% lower than the target set, while sowing area in Sindh was registered at ~0.5mln hectares (~80.5% of the target), ~13.0% and ~19.5% lower than the previous year and FY23 target, respectively. The shift in crop preference has a reason to play for this decline in sowing area.

Source: Economic Survey, 2021-22, PCCC's July-22 Monthly Cotton Price Review

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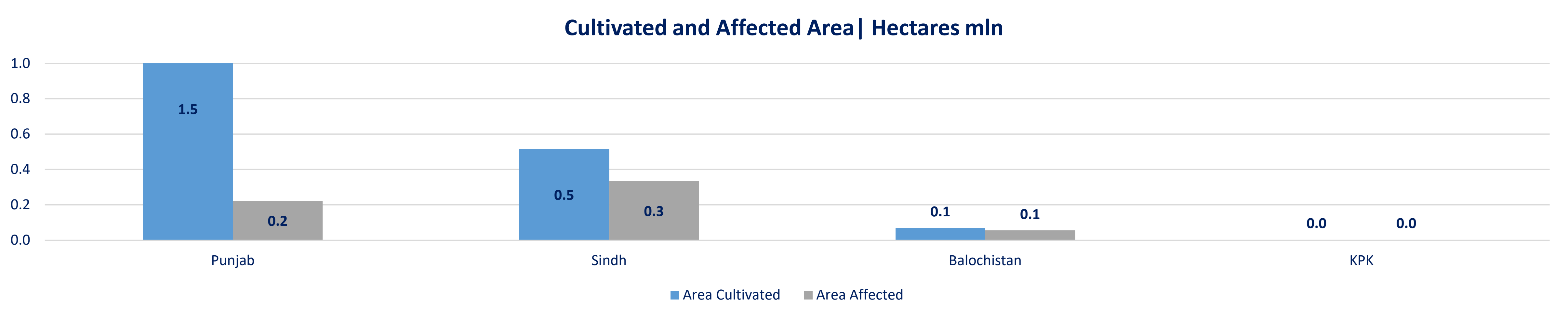
Cotton Dynamics | Monsoon-22 Flashfloods



- The Aug-22 flashfloods were percepitated by unprecedented rainfalls which surpassed Pakistan's 30 years average rainfall spells of ~136.5mm by ~186.2%. Nearly one-third of Pakistan's geographical area was submerged under flood waters. Loss in GDP is projected at ~2.2% of FY22 GDP while the agriculture sector is projected to contract the most, by ~0.9% of GDP.
- The natural disaster has had a significant impact to standing crops including the Kharif cotton crop. While Balochistan's area under cultivation has been the most severely hit – nearly ~80% affected – the greatest damage, in terms of cultivated area has been in Sindh followed by Punjab where ~1.5mln and ~0.5mln hectares were cultivated, respectively, and out of which ~0.3mln and ~0.2mln, respectively have been destroyed (~65% and ~15%, respectively).
- It is pertinent to note that the FY23 production target was ~10.5mln bales which reduced to ~9.0mln bales immediately prior to the floods. However after the floods, this figure estimate has been revised downwards to ~4.8mln bales which amounts to a loss of ~7.0mln bales (or ~60%).
- The estimated yield lost will now need to be imported. With an average local demand of ~12.0mln bales and import demand of ~4.8mln bales, Pakistan's projected import demand could amount to ~12.0mln bales. With an international cotton price of USD~420.39/bale in the 4MFY23 period, Pakistan's import bill can rise by an estimated USD~5bln if the projected quantity is imported.
- In addition, any harvested cotton may be of inferior quality and if used to produce output, will reduce the quality and competitiveness of output.

Note: Cotton price is based on the 4MFY23 average price

Source: Economic Survey, 2021-22, PCCC's November-22 Daily and Monthly Cotton Price Review, NDMA, PACRA Internal Database, World Bank Pink Sheer, USDA

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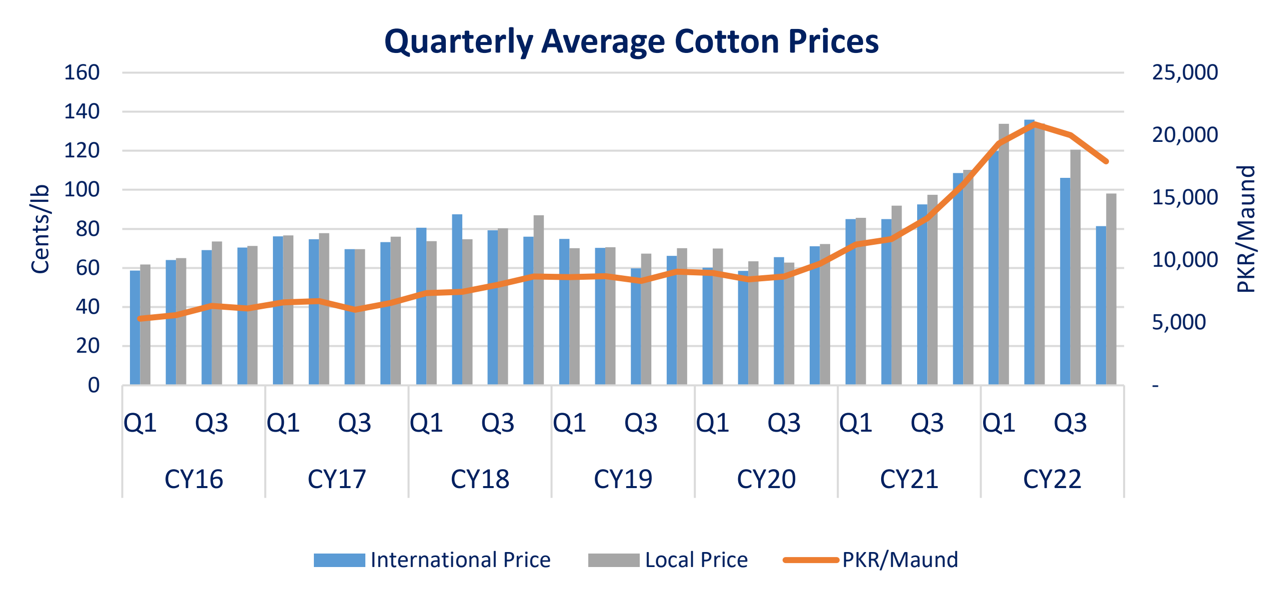
Cotton Dynamics | Prices

- International cotton futures prices peaked until Apr-22 touching 138 cents/lb in the international market and 135 cents/lb in the local market.
- International prices have exhibited a downward trend post 2QCY22 falling from an average of 136 cents/lb in 1QCY22 to a price of 81 cents/lb. In the recent past, prices were this low is Jan-21 and the latter was in the COVID-19 era when global demand was significantly supressed.
- Globally, the CY22 dip in cotton prices is primarily attributable to a weakening in demand forces amidst a global economic slowdown.
- Another variable influencing global cotton prices in the sluggish import demand from China, the world's largest importer, which has built significant stockpiles within the country in the recent past.
- However, global cotton prices have experienced significant volatility in CY22 and this is attributable to speculators betting on global supply and demand forces. Prices jumped by ~13% between 1QCY22 and 2QCY22 before dropping by ~28% in 3QCY22.
- Local average cotton prices (in PKR/maund) in the 4MFY23 period continue to remain high compared to the SPLY when prices were ~110% lower despite a drop in the local price in cents/lb. This is because of the ~29% appreciation of the PKR/USD rate in FY22 (SPLY: ~-4%).
- However, local cotton prices in Oct-22 have eased from the PKR~23,000 per maund level observed at Aug-22 end.



Average Cotton Prices	FY18	FY19	FY20	FY21	FY22	4MFY23
International (Cents/lb)	78	76	62	76	114	97
Local (Cents/lb)	74	78	68	78	123	109
Local (PKR/maund)	6,888	8,604	8,742	10,290	13,476	18,674

Cotton Unit Conversion	
Unit	**Conversion**
1 Maund	37.3kg
1 Bale	170kg
1 Bale	4.6 Maund

Source: PCCC

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Yarn and Fabric Production

- Pakistan's annual production of yarn and fabric has remained relatively stable in the past few years. During FY22, the production of both yarn and fabric grew by ~0.5% and ~0.1%, respectively (SPLY: ~15.0% and 12.5%, respectively).
- In the 3MFY23, cotton yarn production grew by a marginal ~0.01% while cloth production increased by ~0.07% owing to a global economic slowdown which has diluted export demand significantly.
- The cloth/fabric sector is plagued with problems relating to poor technology and lack of quality yarn which has led to the production of low value added grey cloth of mostly inferior quality.
- Synthetic or blended yarn has the largest share of total yarn production. Moreover, there is greater production of coarse and medium type yarn as compared to fine cotton yarn. This has a negative impact on quality of fabric and finished goods as fine yarn is considered to be of a higher quality.
- Production of grey cloth has the greatest share in overall cloth production followed by dyed and printed cloth.

Production of Yarn (MT)	FY18	FY19	FY20	FY21	FY22	3MFY23
Coarse	787,376	790,223	707,859	891,807	896,253	219,554
Medium	826,399	823,784	736,102	929,683	934,318	228,879
Fine	393,126	395,655	350,887	96,715	97,197	23,810
Super Fine	88,406	85,799	75,905	85,372	85,797	21,018
Synthetic/Blended	1,334,743	1,335,929	1,179,423	1,506,799	1,514,310	370,959
Total	**3,430,050**	**3,431,390**	**3,050,176**	**3,510,376**	**3,527,874**	**864,220**

Production of Fabric (000 Sq. M)	FY18	FY19	FY20	FY21	FY22
Grey	582,812	583,364	521,212	584,670	585,713
Bleached	111,110	114,146	101,985	78,970	79,143
Dyed & Printed	269,082	267,397	238,908	304,564	305,233
Blended	80,736	81,073	72,435	80,484	80,661
Total Organized Mill Production	**1,043,740**	**1,045,980**	**934,540**	**1,048,447**	**1,050,750**
Unorganized Mill Production	8,127,160	8,101,820	7,239,019	8,128,845	8,137,787
Total Fabric Production	**9,170,900**	**9,147,800**	**8,173,559**	**9,177,292**	**9,188,833**
Growth	**0.01%**	**-0.25%**	**-10.65%**	**12.50%**	**0.13%**

Source: TCO, PBS, Economic Survey 2021-22

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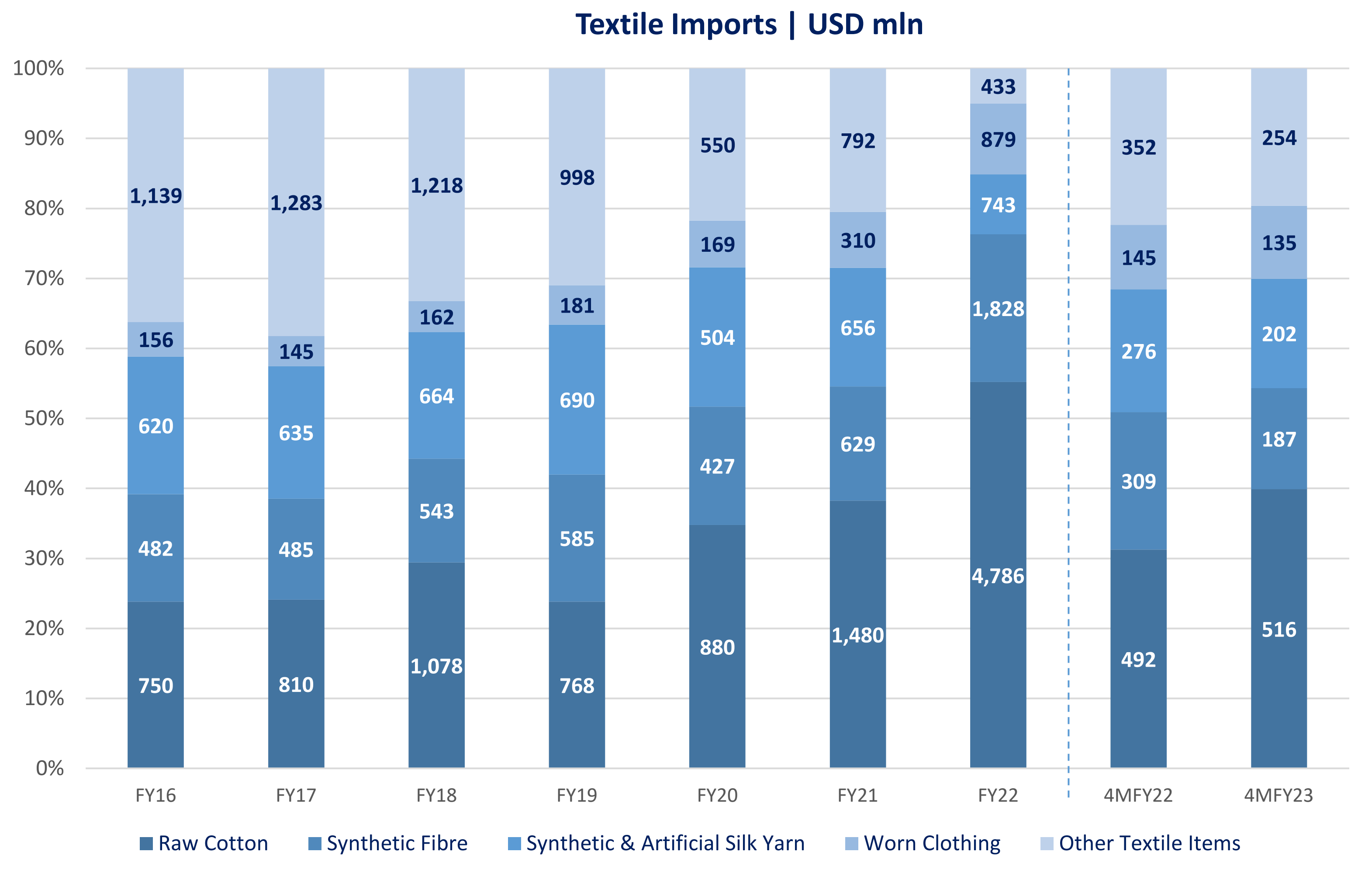
Textile Imports

- The impact of a global economic slowdown and subdued global and local demand pressures are now being reflected in the import figures for the 3MFY23 period which cumulatively dropped by ~17.9% in USD terms.
- The greatest volumetric drop in imports was of synthetic fibre (~49.4%) followed by synthetic and artificial yarn (~33.2%). Raw cotton imports, in volumetric terms, fell by ~23.8%.
- The value increase in imports was merely due to average value of the USD relative to the PKR which stands at ~223.17 on November 24, 2022 (SPLY: ~167.55).



Source: PBS

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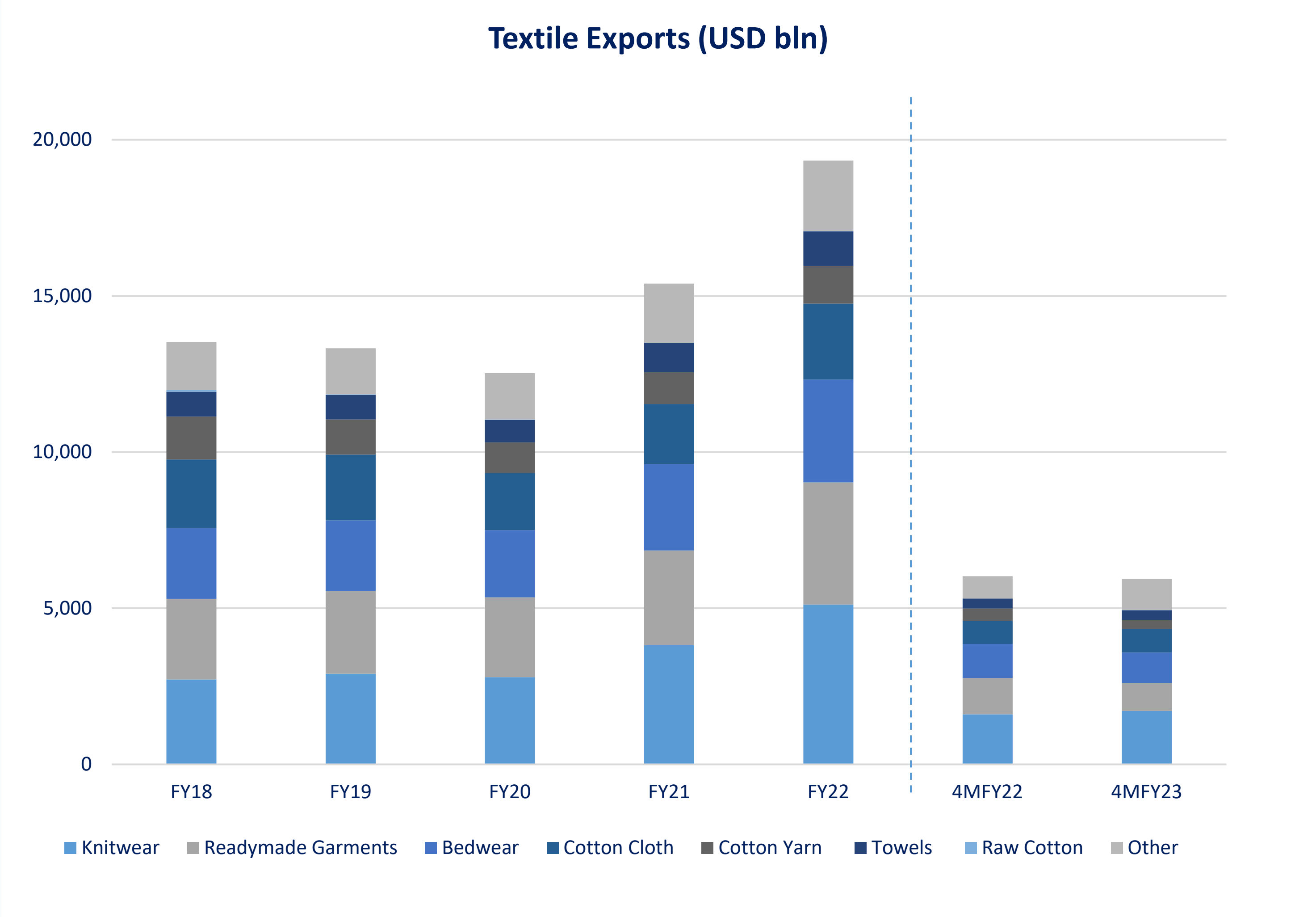
Textile Exports

- Pakistan's textile exports fell by ~1.4% in the 4MFY23 period to USD~5.9bln from the SPLY. This follows the successful FY22 year wherein exports accelerated by ~26% or to USD~19.3bln from the SPLY.
- Over the 4MFY23 period, ~58% more knitwear was exported giving rise to value growth of ~7% in USD terms.
- The other segment to contribute positively to exports in volumetric and USD terms was the readymade garments segment; exports rose by ~52% in volume terms and ~2%, respectively, in USD terms.
- Segments which witnessed a decline in export demand in the 4MFY23 period include the bedwear segment (comprising ~18% of exports). Export dispatches declined by ~22% in volumetric terms and ~10% in USD terms.
- The cotton yarn and cotton cloth segments, contributing ~5% and ~13% to export revenues, witnessed a decline of ~38% and ~23% in volumetric terms and ~28% and ~1% in USD terms, respectively.
- Going forward, we expect the situation to be not as favourable on the exports front and Pakistan may witness a dip in the FY23 year compared to the SPLY if worldwide recessionary conditions continue to persist for the remainder of the year.



Source: PBS

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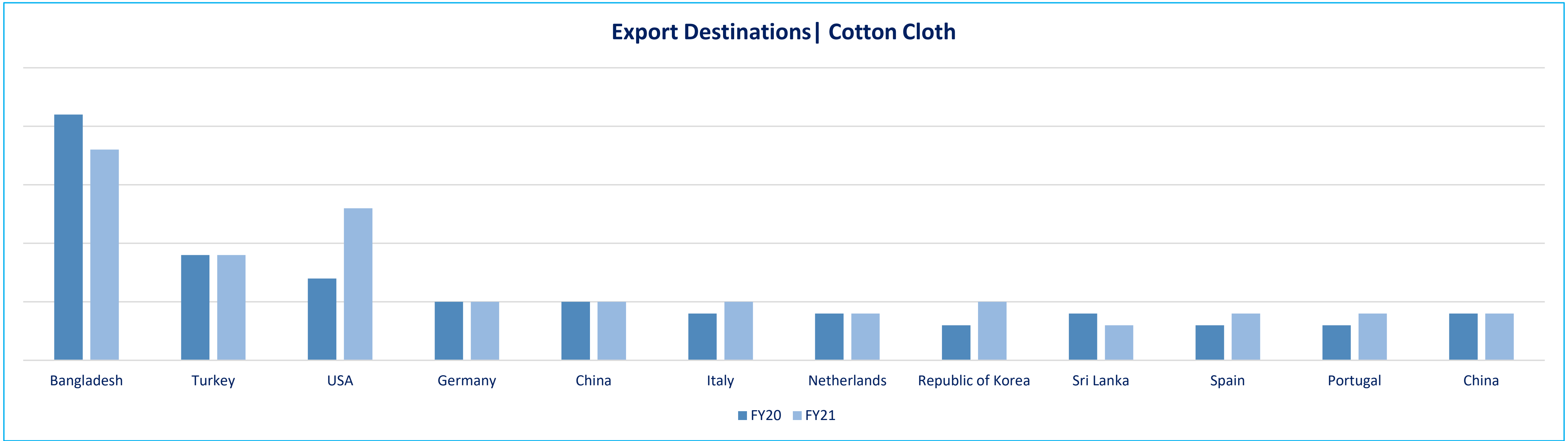
Export Destinations | Cotton Cloth and Yarn



- Portugal is Pakistan's largest yarn customer followed by the US whereby ~5% and ~4%, respectively, of total yarn export revenue was generated from in FY22. Notably, Italy stepped up its exports orders in FY22 resulting in the country generating ~4% of yarn exports revenue for Pakistan. Another large export customer is Turkey with revenue contributing ~4% to yarn export revenue.
- Approximately ~18% of Pakistan's cotton cloth exports are concentrated towards Bangladesh, which is a significant player in the global textile finished goods market.
- Other export destinations include European countries such as Turkey (~9%), Germany and Italy (~5% each), Netherlands (~4%) and Spain (~4%), as well as USA, ~13%. In FY22, export of cotton cloth increased by ~3.8% in volumetric terms and ~26.9% in USD terms.

Source: TDAP, PBS, SBP

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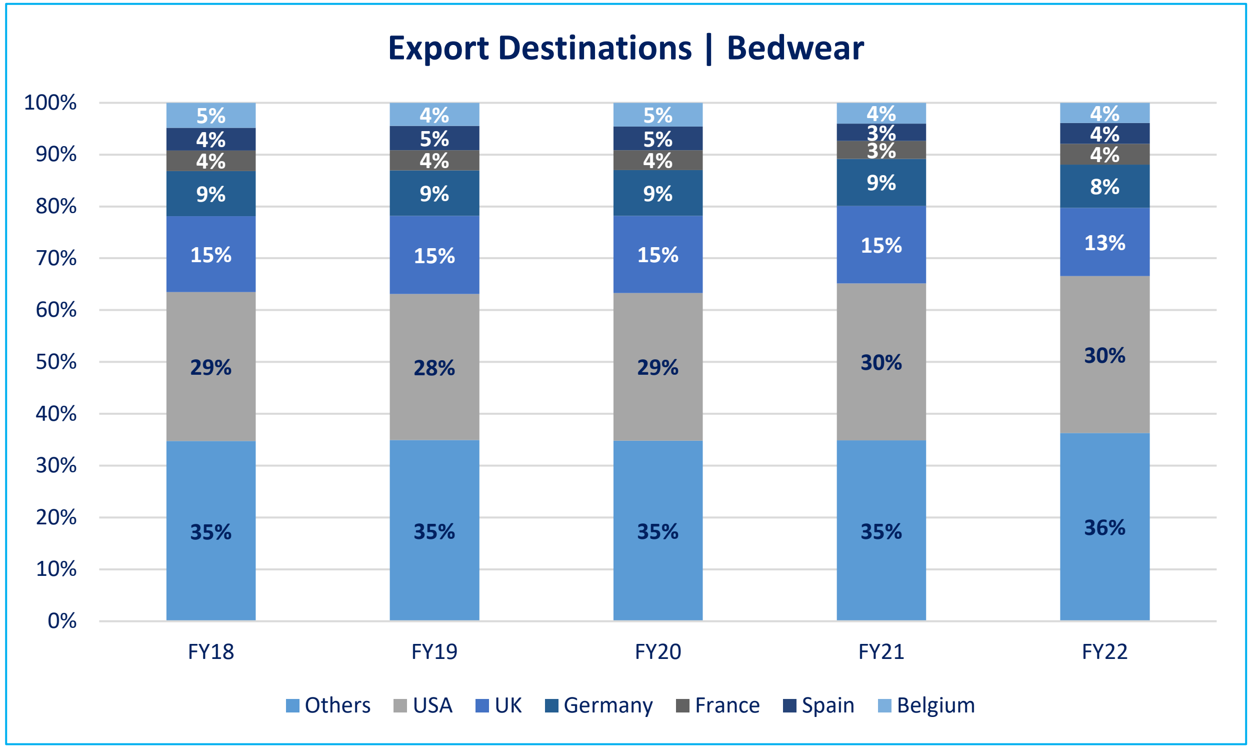
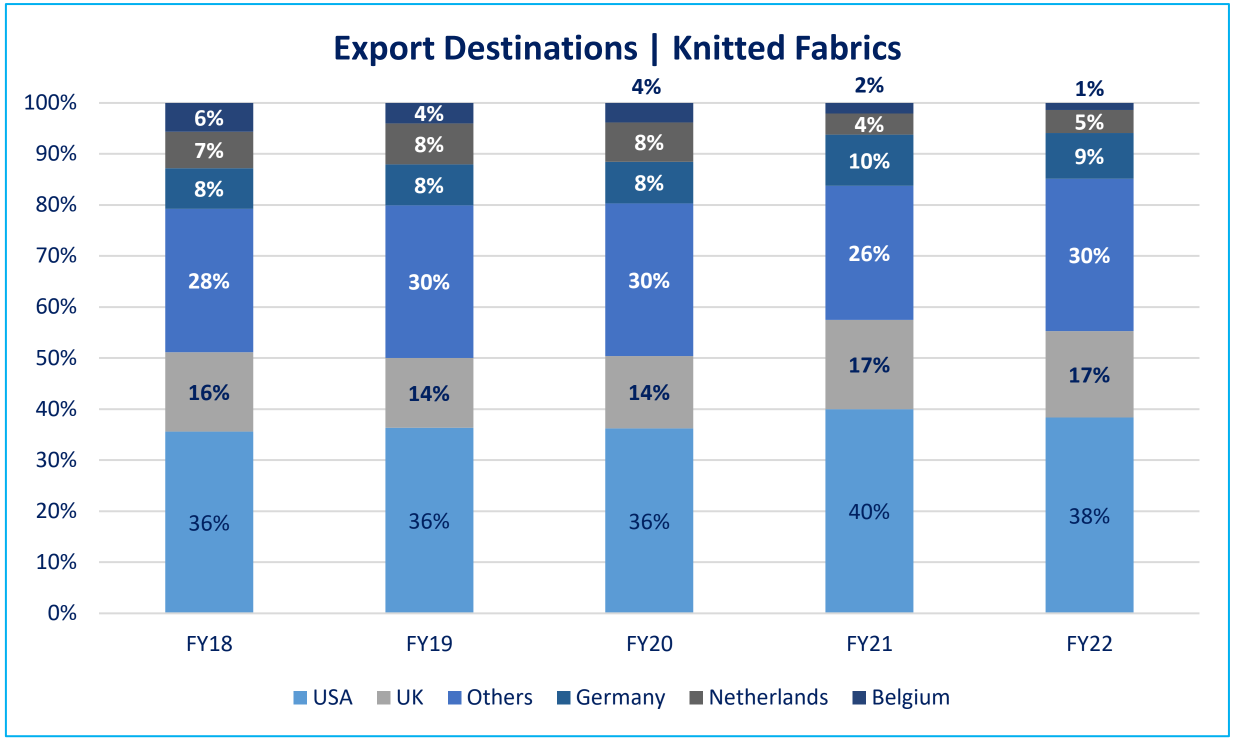
Exports Destinations | Bedwear and Knitted Fabrics





- In FY22 ~30% of bedwear was exported to the USA, the largest customer. UK was the second largest customer with ~13% of export orders delivered followed by France and Germany (~4% each).
- In FY22, knitted fabrics orders from the USA generated ~38% of export revenue while those to the UK generated ~17%. The third highest export revenue from the sale of knitted fabrics was generated from Germany (~9% of total export revenue).

Source: SBP

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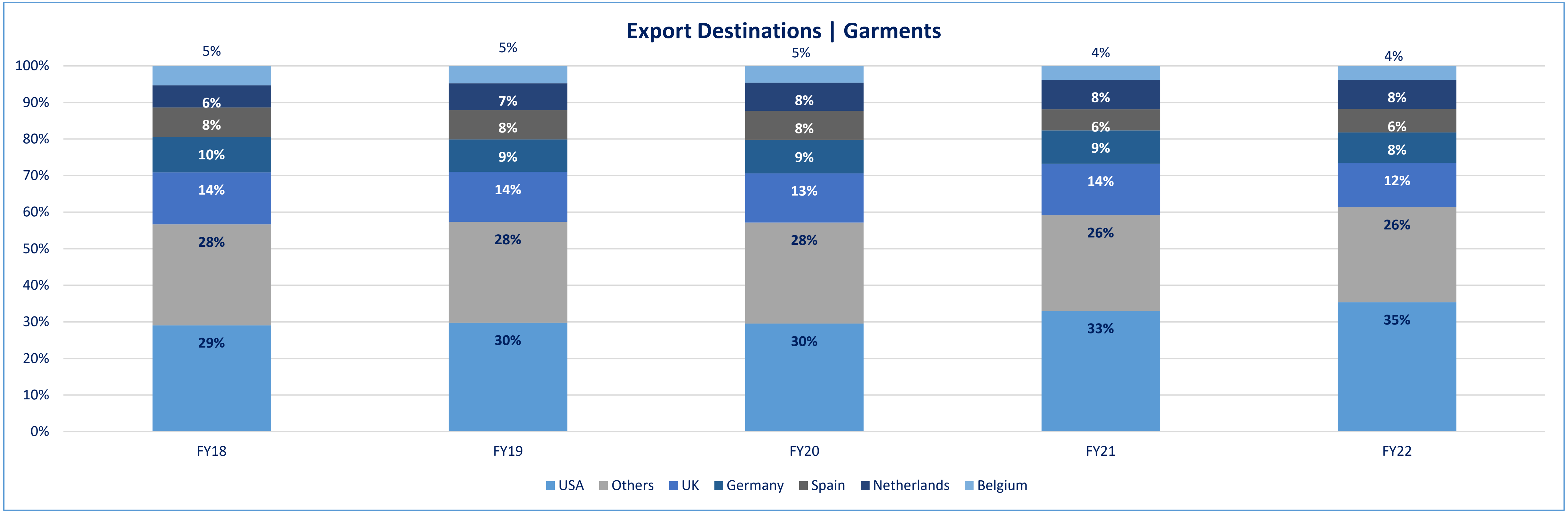
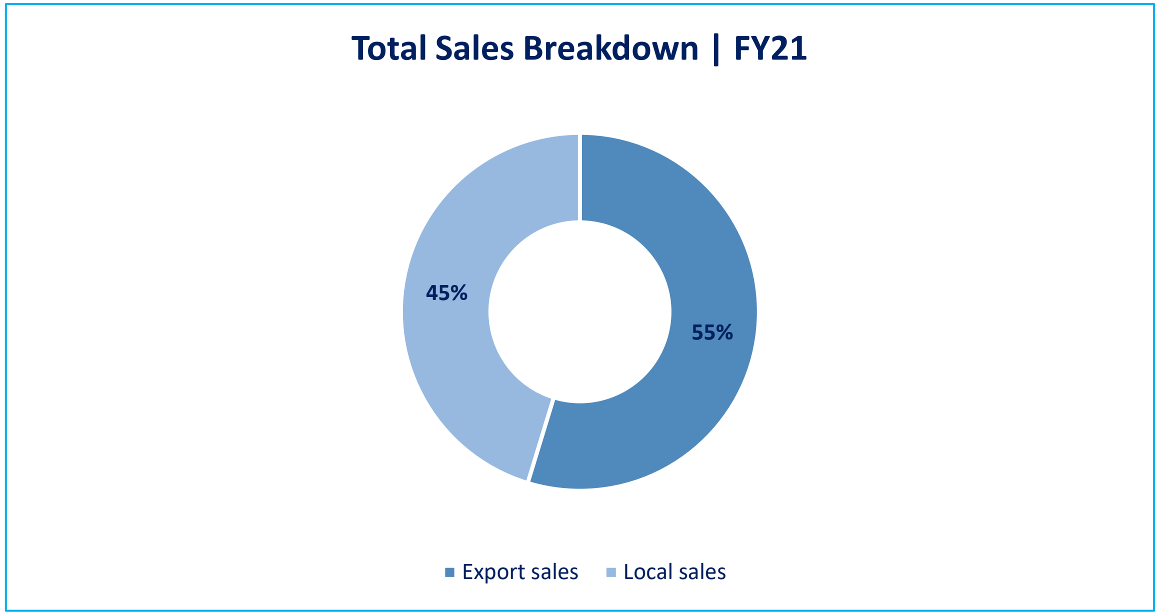
Export Destinations | Garments

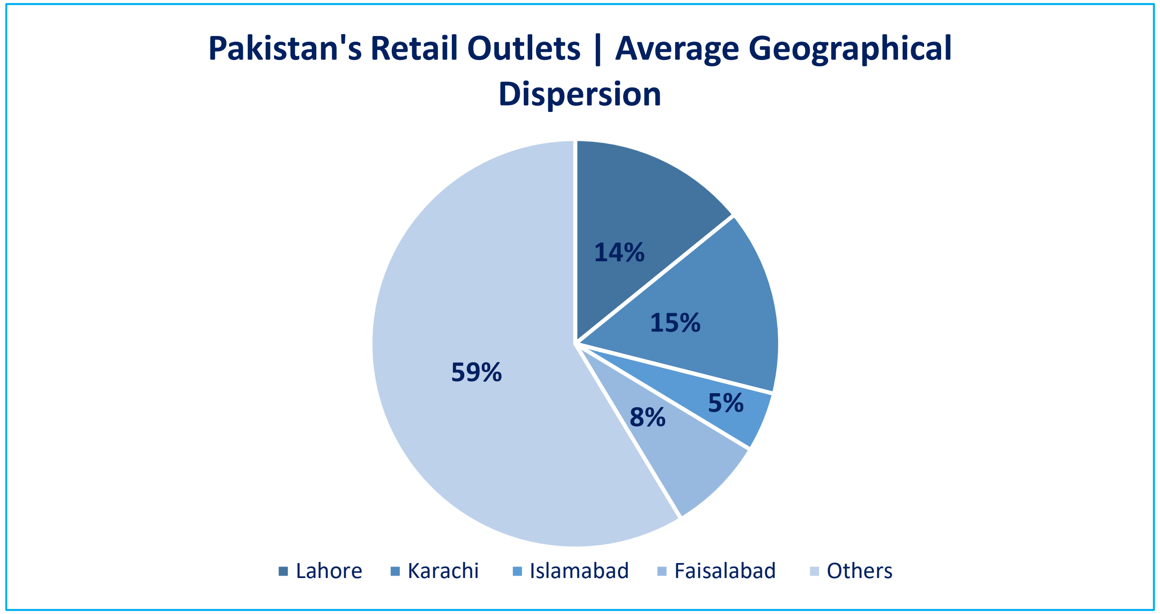


- In FY22 ~35% of garments export sales revenue was generated from the USA; Pakistan's largest garments customer. The second largest customer was the UK from which ~12% in export revenue was generated followed by Germany and Netherlands (~8% each).
- ~6% of total export revenue was generated from Spain while exports to Belgium accounted for ~4% of total revenues.

Source: SBP

Garments | Local Industry





- The garments segment is referred to as an ancillary textile industry with production operations ranging from small-to medium to large-scale.
- In FY22, the contribution of readymade garments (or wearing apparel) and other textile products to the national large-scale manufacturing (LSM) index was ~6% and ~18%, respectively
- The clothing retail industry is highly diverse when it comes to operating structure and size. While the major brands operate via retail outlets and online platforms, the smaller brands conduct their sales operations via the latter medium. A majority of these companies have a horizontally integrated value chain and operate with spinning and weaving units.
- A majority of the major brands conduct their retail operations across Pakistan.
- The major players in the composite sector generate sales from export and local operations; export sales have a greater representation of total retail sales (local sales and export sales) over the two years depicted in the LHS graph.

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Business Risk

- **Decline in local cotton production:** In FY23~60% of Pakistan's cotton crop was destroyed following the Aug-22 monsoon flash floods. Total white lint production dropped to ~4.8mln bales. This is the most significant risk to impact the textile sector as damage to local crop will mean more cotton will need to be imported and with the presently high PKR/USD exchange rate, sourcing raw material from overseas will hurt the bottom lines of industry players. In addition, as at the end of Oct-22, mill arrivals were 29% lower compared to the same period last year which is as a result of the production decline.

- **Dependency on cotton imports:** The estimated ~64% crop damage resulting from the monsoon flash floods increases the dependency on imports. Raw material constitutes ~71% of the sector's direct costs and thus the sector remains vulnerable to fluctuations in the price of the raw material which is at a low level. Profitability depends on the players' ability to continue to pass on the increased price impact.

- **Low level of value addition:** Although, the increased demand in FY22 has increased the overall profitability of the sector, it remains a low value addition sector with historically narrow margins. Moving forward, subdued global and local demand coupled with elevated interest rates and high inflation will pose a significant challenge to the sector.

- **High Energy Costs:** Although the government provides the textile industry with subsidized RLNG at USD~9.0 per mmbtu, which increased from USD~6.5 per mmbtu on August 1, 2022, this rate is above the regional average for countries such as India, Bangladesh and Vietnam which reduced the competitiveness of Pakistan's yarn exports. Furthermore the withdrawal of the RCET and imposition of a fixed power tariff of Rs. 20/kWh has forced smaller mill owners to close down business. In Oct-22 APTMA reports ~1600 mills have been forced to shut down as a result due to the rising power tariff.

- **Disruption in electricity and gas supply:** The composite sector depends on an uninterrupted supply of electricity and gas. Interruptions in energy supply and curtailment of gas supply meant that the industry

- **High level of regional competition:** Pakistan's textile exporters have traditionally faced a high level of competition from regional players such as Bangladesh and Vietnam which has driven down the average export prices and margins in previous years. Although, many regional players were severely impacted by the COVID-19 pandemic which benefited Pakistan, the regional competition continues post the pandemic.

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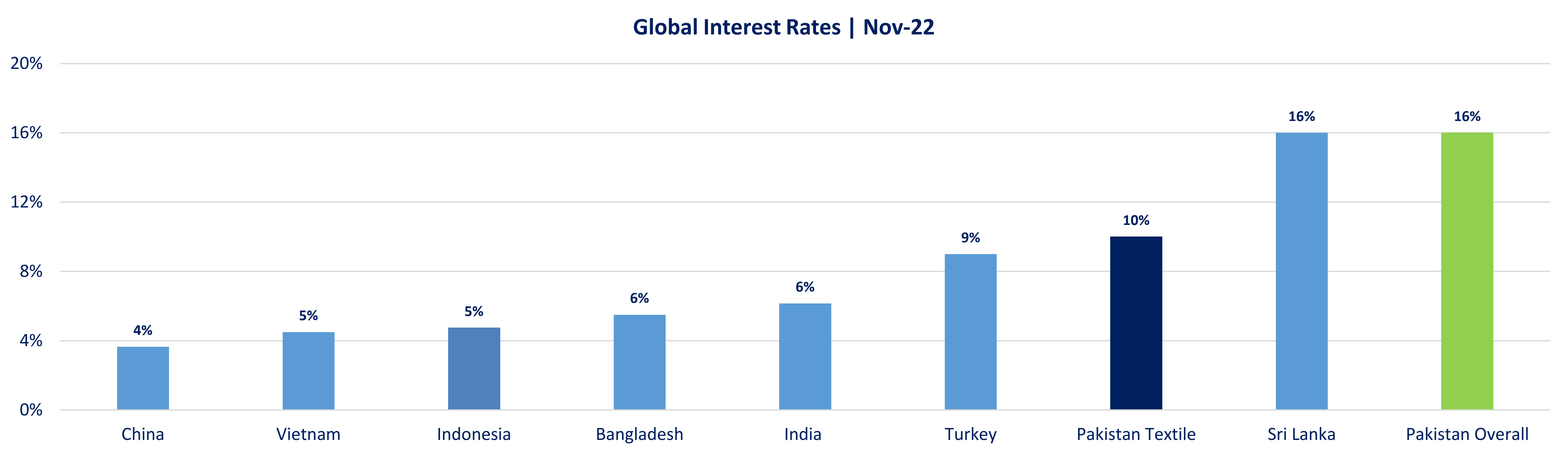
Local Industry | Regional Cost Comparison



- With the recent hike in policy rate (15% to 16% in Nov-22), Pakistan has the highest interest rate in the region in line with Sri Lanka. The high cost of borrowing acts as a barrier to investments in various sectors.
- Prior to FY22, the textile sector was a beneficiary of subsidized financing facilities from the SBP in the form of short term Export Refinance Facility (ERF) and Long Term Financing Facility (LTFF). In July-22 the SBP announced that any subsequent revisions in the LTFF and EFR rates will be linked to policy rate revisions such that the difference between the former two rates and the latter is maintained at 5%; the latter two rates were revised to 10% in Jul-22 and 11% in Nov-22. This serves to increase the cost of borrowing for the sector which has already experienced a jump in borrowing costs in the 3MFY23 period.

**Energy tariffs for Pakistan have been converted in cents/kWh based on the mark-to-market rate on November 25, 2022*

Source: Trading Economics, globalpetrolprices.com, APTMA, OGRA

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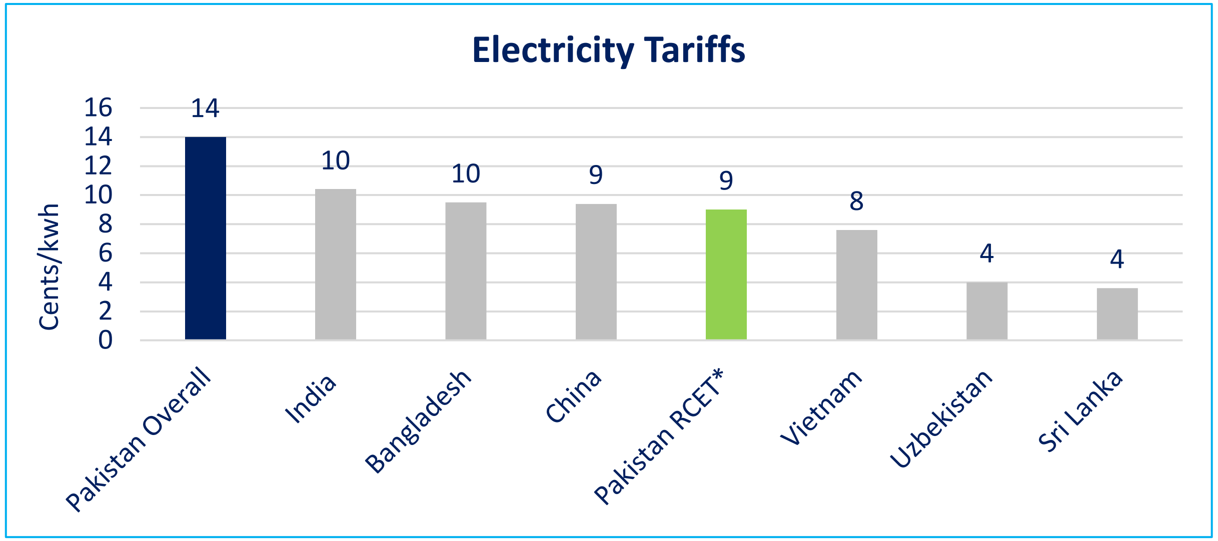
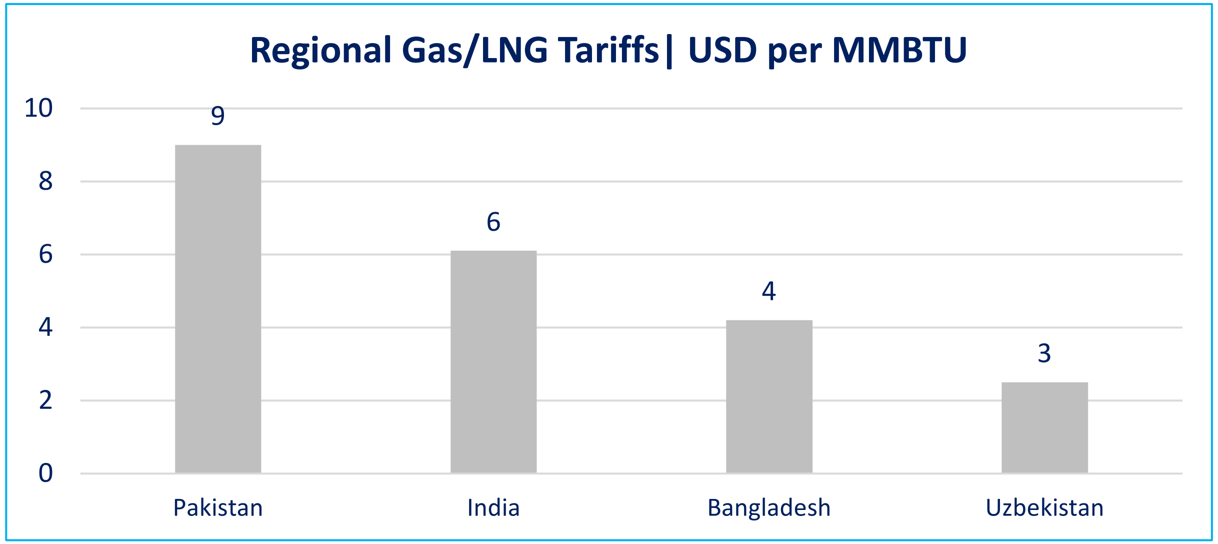
Electricity and Gas Tariffs | Local Issues and a Regional Comparison





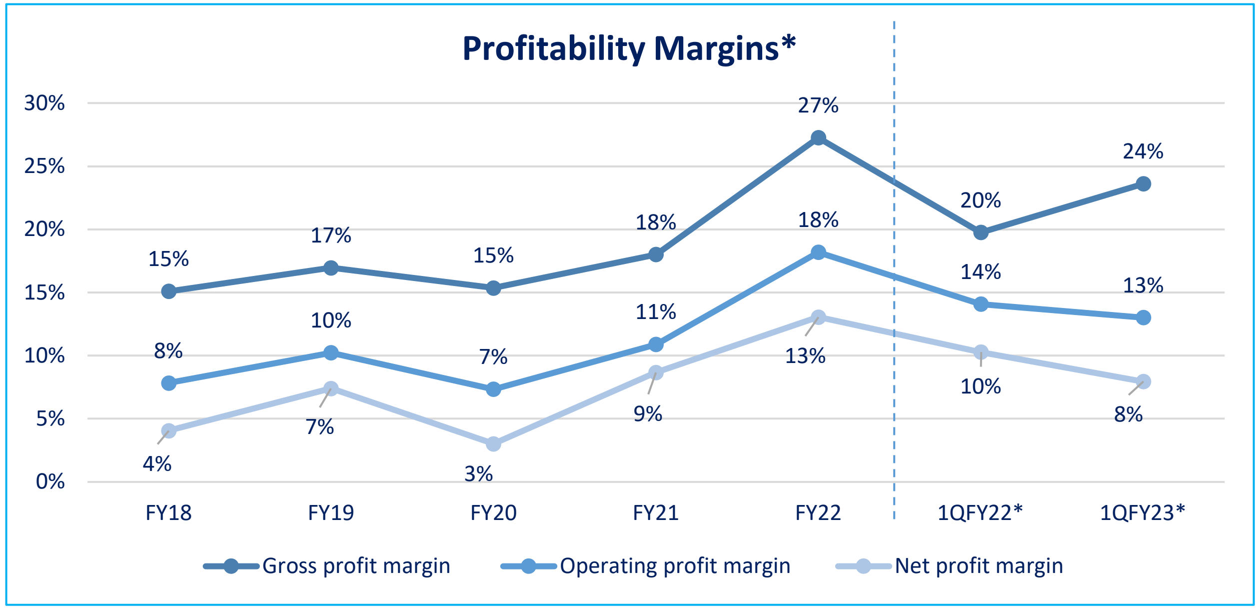
- Pakistan's businesses face a competitive disadvantage when it comes to comparing national and regional electricity tariffs. Energy costs have a significant share in the final conversion costs of textile mills and these costs cannot be ignored for achieving a competitive edge.
- The government provides gas at internationally competitive prices or at regionally competitive energy tariffs* (RCET) to the five export-oriented sectors of the economy including the textile cluster. However, these RCETs are still higher when compared to tariffs in Vietnam, Uzbekistan and Sri Lanka. Disruptions in the supply of electricity from the national grid (loadshedding and fluctuations) due to obsolete infrastructure and disconnection of gas supply make it challenging to rely on these energy supply sources. Furthermore, the onset of winter means the little gas provided to the sector will also be curtailed.
- Effective October 1, 2022 to June 3, 2023, electricity is now being provided at an all-inclusive subsidized rate of Rs. 20 per kWh. In Aug-22, gas rates have been increased to USD~9.0 from USD~6.5 per mmbtu in light of higher import prices for RLNG which is being sold at a retail price of USD~14.44 per MMBTU in Nov-22.
- Gas remains the major or only source of energy to ~75% of the textile industry which consumes only ~8% of the national gas supply. Therefore, any disconnection of gas has severe consequences for the local textile industry and export orders. In FY21, total gas supply was 4,300 MMCFD out of which 368 MMCFD was consumed by the textile industry. Compared to regional al players, the local textile industry's gas/LNG tariff is significantly higher.

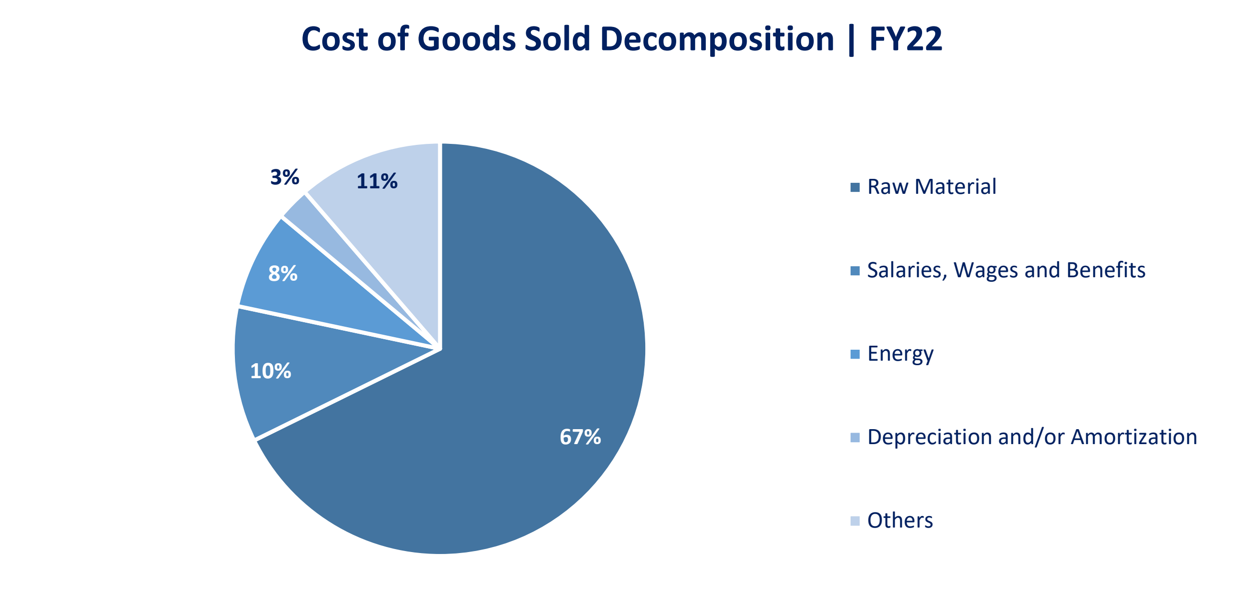
**Pakistan's RCET figures are based on latest figures while other energy tariffs are based on CY21 figures*

Source: Trading Economics, globalpetrolprices.com, APTMA, OGRA

Composite and Garments

Margins & Cost Structure





- Over the five full fiscal years depicted on the LHS graph, FY22 was the most successful for the composite sector as performance more than offset the trough in FY20 (the pandemic year). Gross; operating; and profitability margins increased by ~9%; ~7%; and ~4%, respectively, in FY22 compared to the SPLY. Increase in volumetric sales and a lower PKR value relative to the USD, both contributed to an increase in export revenue in local currency terms. Local sales also experienced volumetric growth.
- However, while the gross margins increased in 1QFY23 by ~4% compared to the SPLY, operating margins and net margins fell by ~1% and ~2%, respectively, owing to higher electricity costs and finance costs; the latter increased by ~374% from the SPLY owing to increase in concessional borrowing and policy rates. Moreover, the increase in gross profit margins is majorly due to the depreciation of the PKR relative to the USD which has increased the value of export revenues in recent times more than increase in volume.
- Raw material is the most significant component of cost of sales (~67%) and this dependency highlights the susceptibility of margins to this input source.

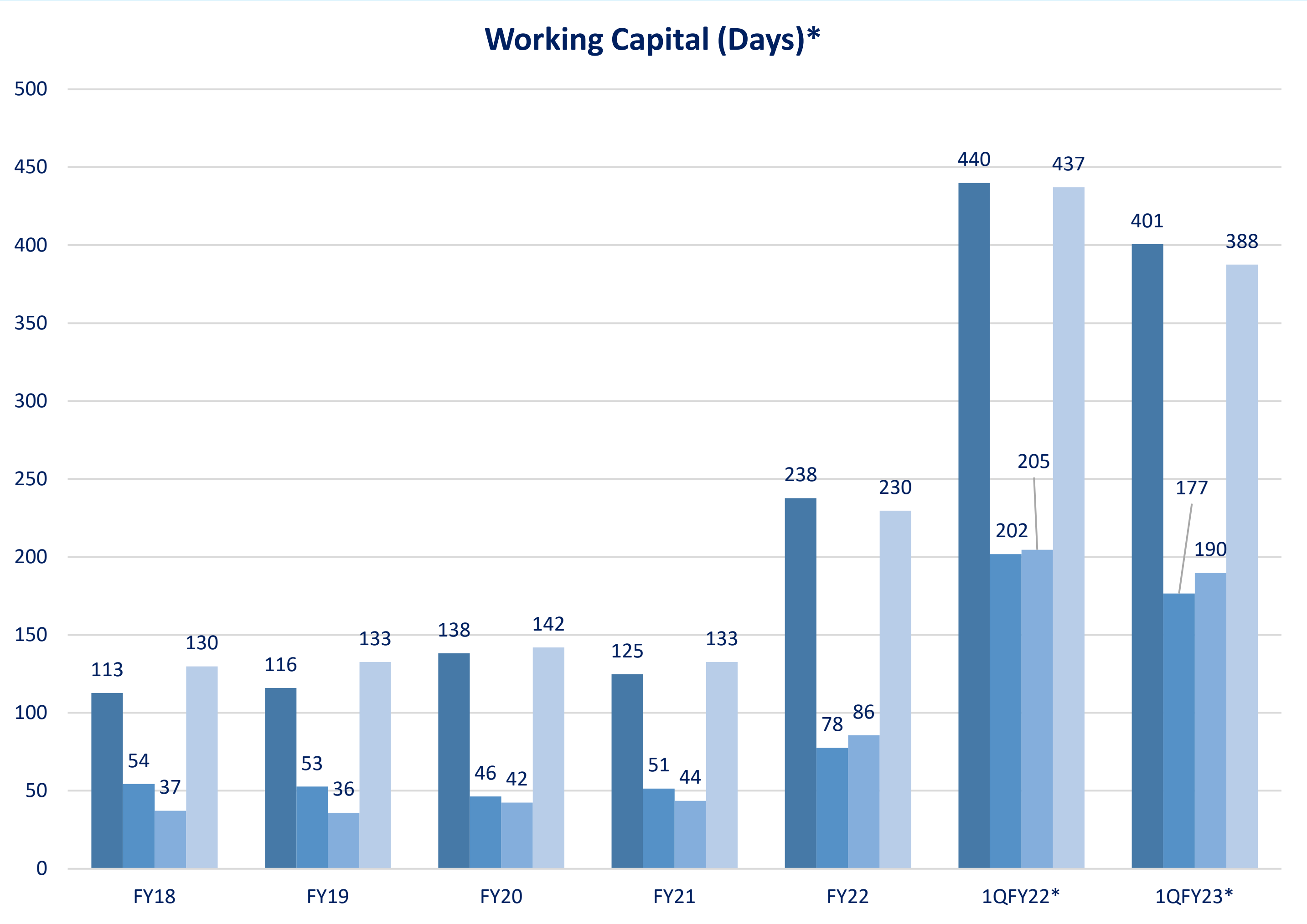
*Due to limited availability of data, working capital for 1QFY22 and 1QFY23 reflects listed players' financial data

Source: PACRA Database, PSX

Composite and Garments

Financial Risk | Working Capital Management

- The composite sector’s working capital is largely a function of inventory and trade receivables. Inventory is the most significant component and majorly includes raw material and finished goods, with work-in-process making the smallest contribution.
- The average working capital cycle for the industry is ~153 days - a relatively larger period than other textile sectors due to the fact that composite units encompass multiple processes within the textile value chain.
- The net working capital days in FY22 were higher by ~97 days compared to SPLY and this was mainly due to excessive build-up of cotton inventory by spinners as cotton prices fell globally. Furthermore, the final quarter of FY22 witnessed a downtrend in orders as a slowdown of the global economy and reduction in export orders was experienced.
- Inventory days have been observed to be higher in the first quarter of the fiscal year and this is owing to arrival of cotton into the warehouses of spinners from fields and the build-up of inventory for resale in the warehouses of other segments of the value chain.



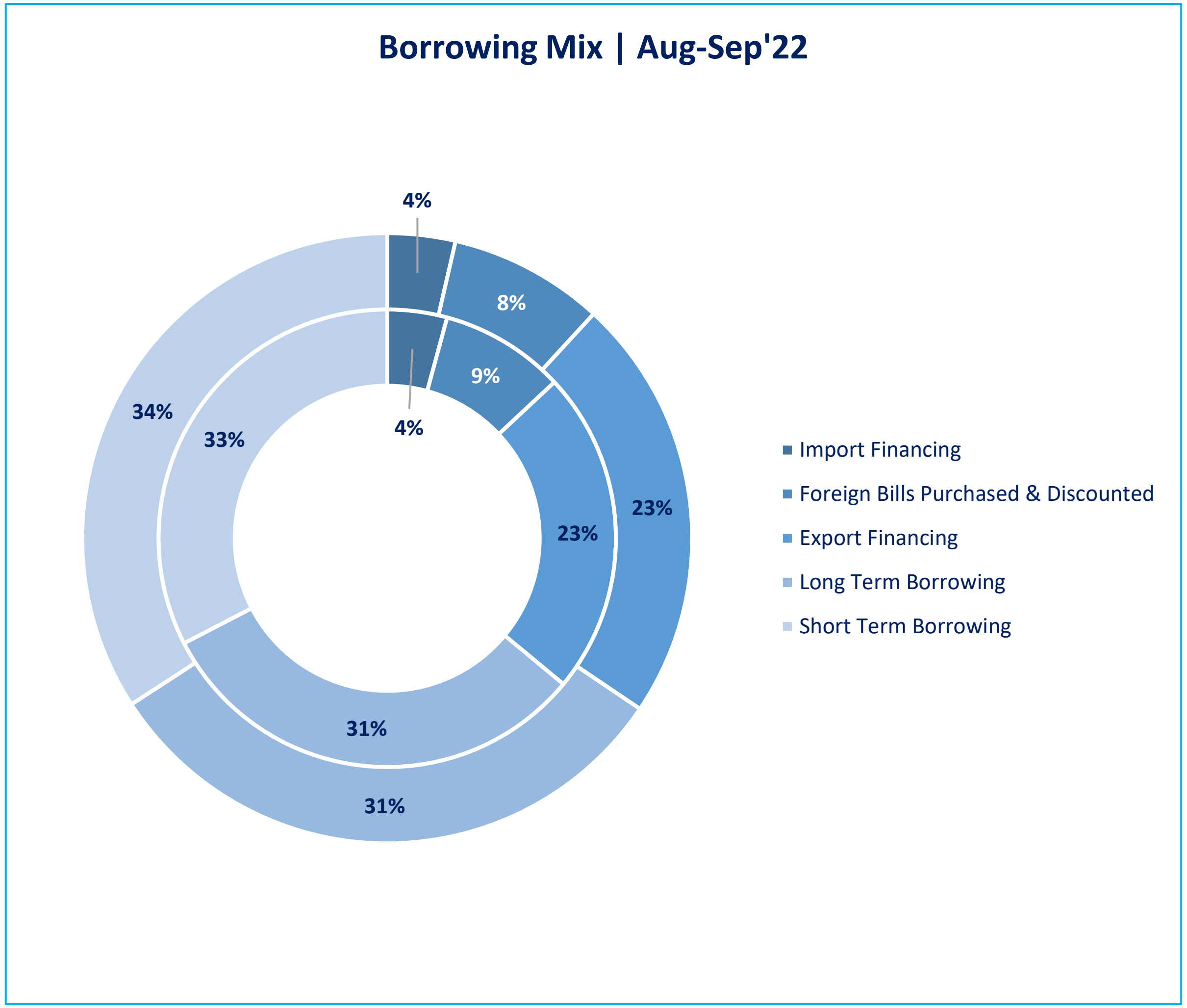
**As per availability of data, working capital for 1QFY22 and 1QFY23 reflects 25 listed players’ financial data*

Source: PACRA Database, PSX

Composite and Garments

Financial Risk | Borrowing Mix

- The total borrowing for textile sector in Sep’22 stood at PKR~1,694bln as compared to PKR~1,647bln in Aug’22
- The largest component within the borrowing of textile sector is discounted borrowing, amounting to ~44% of the total borrowing. This includes Export Finance Scheme (EFS) at rate of 10.0%, as well as Long Term Finance Facility (LTFF) and Temporary Economic Refinance Facility (TERF) at rate of 10.0%. It is pertinent to note that these two rates have been revised upwards to 11.0% in line with the policy rate hike in Nov-22.
- Total discounted borrowing amounted to PKR~740bln as at End-Sep’22 (EFS: PKR~383bln, LTFF/TERF: PKR~358bln).
- The sector’s short term borrowing at normal rates accounts for ~34% of total borrowing and stood at PKR~579bln as at the end of September-22.
- The average leveraging for the textile composite sector in FY22 was moderate and stood at ~48%. However, this climbed to ~52% in the 1QFY23 (SPLY: ~52%)
- As of September-22, the total non-performing loans (NPLs) of the textile industry stood at PKR~161bln while in terms of ratio were recorded around ~8.4% (June-22: ~8.3%). Textile NPLs continue to remain above the total infection ratio of ~7.6% of the private sector banking credit indicating higher level of financial risk.



Note: Average leveraging is reflective of 52 listed/rated players. 1QFY22 and 1QFY23 leverage figures reflect 25 listed players

Source: SBP

Regulatory Framework

- With respect to Income Tax, the composite sector is under the Normal Tax Regime (NTR). Further, the sector is also subject to Minimum Tax @ 1.5% of turnover, if tax liability under NTR is lower than minimum tax. However, the additional tax paid under minimum tax is adjustable against future tax liabilities for the next 5 years.
- In FY22 finance bill, a super tax was introduced and will be imposed at a rate of 10% on textile manufacturers whose income exceeds PKR~300bln.
- In addition, sales tax of 17% is applicable on both the raw material, i.e. cotton and finished goods, i.e. yarn. In addition to Sales Tax, there is Advance Tax of 1% applicable on the import of these products. However, the amount of Advance Tax is adjustable against final income tax liability.
- The sector receives discounted financing from SBP under the Export Finance Scheme (EFS) and the Long Term Financing Facility (LTFF). In July-22, the SBP announced that the two mark-up rates for the two aforementioned rates will be linked to the policy rate such that the difference between the former two, on the one hand, and the latter, on the other, is equal to 5%. This gap is subject to revisions in future economic activity.
- In response to the COVID-19 pandemic, SBP introduced several measures intended to provide relief to the industries. These measures included loan extension and refinancing, loan for payment of employee salaries and wages and facilitation of new investment, expansion and BMR activities through the Temporary Economic Refinance Facility (TERF) with a ten-year maturity loan facility. While the TERF scheme has been withdrawn by the SBP, corporate loans under this facility have not yet matured and continue to be reported on the financial statements of sector players.
- The SBP increased the monetary policy rate by 250 bps to 12.25% in April-22 and a further 150 basis points to 13.25% in May-22. In FY23, the policy rate has been hiked upwards twice: to 15.00% in July-22 and by a further 100 basis points (to 16.00%) in November-22. The consistent upward revision in rates has served to increase sector borrowing costs and linked EFS and LTFF markup rates.
- All Pakistan Textile Mill Association (APTMA) acts as the national trade association of textile cluster in the country.

Source: SBP

Composite and Garments

Custom Duty Structure

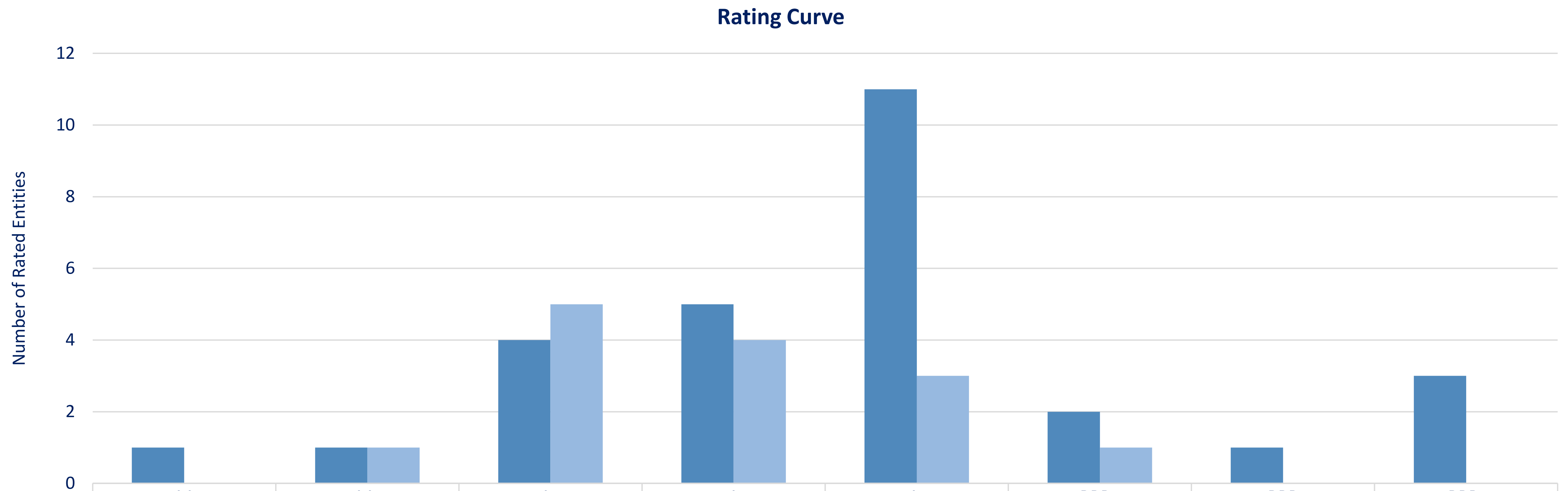
PCT Code	Description	Custom Duty		Additional Custom Duty		Regulatory Duty		Total	
		FY23	FY22	FY23	FY22	FY23	FY22	FY23	FY22
52.01	Cotton, not carded or combed	0%	0%	0%	0%	0%	0%	0%	0%
52.03	Cotton, carded or combed	0%	0%	0%	0%	0%	0%	0%	0%
52.04	Cotton sewing thread, whether or not put up for retail sale	16-20%	16%	0%	4%	0%	0%	0-20%	20%
52.05	Cotton yarn (other than sewing thread), containing 85% or more by weight of cotton, not put up for retail sale	11%	0%	0%	0%	0%	0%	11%	0%
52.06	Cotton yarn (other than sewing thread), containing less than 85% by weight of cotton, not put up for retail sale	11%	0%	0%	0%	0%	0%	11%	0%
52.07	Cotton Yarn (other than sewing thread) put up for retail sale	11%	0%	0%	0%	0%	0%	11%	0%
52.08	Woven fabric of cotton, containing 85% or more by weight of cotton, weighing not more than 200g/m2	11%	11%	0%	2%	2%	0%	13%	13%
52.09	Woven fabric of cotton, containing 85% or more by weight of cotton, weighing more than 200g/m2	11%	11%	0%	2%	2%	0%	13%	13%
52.10	Woven fabrics of cotton, containing less than 85% by weight of cotton, mixed mainly or solely with mand-made fibres, weighting not more than 200g/m2	11%	11%	0%	2%	2%	0%	13%	13%
52.11	Woven fabrics of cotton, containing less than 85% by weight of cotton, mixed mainly or solely with mand-made fibres, weighting more than 200g/m2	11%	11%	0%	2%	10%	0%	21%	13%
52.12	Other woven fabrics of cotton	16%	16%	0%	4%	0%	0%	16%	20%
61.01-61.17	Knitted or crocheted clothing articles and accessories	20%	20%	0%	6%	10%	10%	30%	36%
62.01-62.17	Clothing articles and accessories (other than knitted and crocheted)	20%	20%	0%	6%	10%	10%	30%	36%
63.01-63.07	Other made up articles (including blankets, bedsheets, towels etc.)	3-20%	20%	0%	6%	10%	10%	0-30%	36%

Source: FBR

Composite and Garments

Rating Curve

- PACRA rates 28 textile composite players with a long term rating bandwidth ranging from BBB- to AA.



	AA	AA-	A+	A	A-	BBB+	BBB	BBB-
PACRA	1	1	4	5	11	2	1	3
VIS	0	1	5	4	3	1	0	0

Source: PACRA Database, VIS

Composite and Garments

SWOT Analysis

Strengths

- Low cost labor
- Mature and long-standing textile sector
- Strong sector association resulting in high lobbying power

Weaknesses

- Imported machinery
- Low BMR resulting in technological obsolescence
- Dollar based input costs leads to thin margins as a result of inefficiencies
- Interdependency on demand from developed markets
- Exposure to economic cycle shifts

Opportunities

- Forward and horizontal integration can be used to produce value added and differentiated products
- Opportunity to increase efficiency through technological upgrade
- Special Economic Zones provide incentives to sector
- Isolation of Chinese manufacturers by US and European retailers and the pursuit of alternative regional sources to meet order demand.

Threats

- Geographical export concentration
- Intense competition from regional players in international market
- Strong bargaining power of buyers
- Withdrawal of tax credits for expansion and replacement has hindered new investments
- Declining/low quality local cotton production resulting from climate-induced natural disasters and pests.
- Rising borrowing costs (EFS, LTFF and KIBOR) as well as local and global inflation increase the cost of doing business.

Composite and Garments

Outlook: Watch

- The textile industry is a significant contributor to Pakistan's PKR~67trln GDP (~8.5%) and has a significant share (~18.2%) in the Large Scale Manufacturing (LSM) Index. The industry is vital to Pakistan's economy providing employment to ~40% of the national labor force.
- The importance of the sector can also be gauged by its significant contribution to national exports. In FY22, the textile sector fetched USD~19bln (SPLY: USD~15bln) in export revenue equating to ~61% share of the total country exports.
- However, this success was not enjoyed for long as global macroeconomic forces started to weigh down on the performance of a sector which heavily relies on export sales. Beginning September-21, the economies around the globe started overheating leading to restrictive policy stances by respective central banks. The outcome of these measures has now pushed the global economy into recession. With a slowdown in global economic cycles coupled with high inflation, trade partners have reduced their export orders as demand forces dwindle. Consequently, local players, which enjoyed handsome profitability margins growth in FY22 compared to the SPLY (net profit growth: ~6%), are experiencing a slower profitability growth in the 1QFY23 period (operating profit growth: ~-1% and net profit growth: ~-2%). Growth in gross profit margin in this period was mainly due to the depreciation of the PKR relative to the USD as opposed to increase in volumetric sales. In the 4MFY23 the PKR depreciated by ~6% in value.
- Moving forward, a further squeeze in profitability is expected as inflationary pressures in key trading partner nations as well as Pakistan (average CPI in the 4MFY23 period is ~25.5% versus ~8.8% in the SPLY) are not showing any signs of easing; demand forces will continue to remain low.
- Additional problems to impact the sector are frequent revisions in policy rate and the linked EFS and LTFF margins. From Sep-21 to Nov-22, the policy rate has increased by ~121% and this is reflected in the ~374% increase in borrowing costs in the 1QFY23 period (compared to the SPLY) in our sample of 25 listed players. This increase is seen as detrimental to a sector which relies heavily on discounted borrowing, comprising ~44% of total borrowings, and direly needs a technological upgradation of equipment to incorporate digital manufacturing all of which requires significant financing and investment.
- Adding to the industry's woes is energy supply and quality, ~75% of the industry relies on gas-based electricity as supply from national grid is uneven. Furthermore, with the winter season gas shortages and curtailments will serve as an additional challenge to mill operators particularly those of a smaller scale, which have been forced to halt operations. Compared to the SPLY, cost of sales in the 1QFY23 period of our sample increased by ~20% owing to higher raw material and energy costs.
- Lastly, the devastation or inferior quality cotton crop harvested from flood stricken areas will mean ~7.0mln bales will need to be imported at an appreciated USD rate. Small mill owners, who rely on locally harvested cotton, may produce inferior quality output which, in turn, may impair the competitiveness of Pakistan's exports.
- With the US and European ban of Chinese cotton, potential still exists for Pakistan's composite sector. However, structural reforms, diversification, technological innovation and a sustainable, long-term energy policy along with cotton research and economic revival are key survival factors for a sector plagued with its present day challenges.

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